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No. 06-484

IN THE

Supreme Court of the United States

TELLABS, INCORPORATED and RICHARD NOTEBAERT,
Petitioners,

v.

MAKOR ISSUES & RIGHTS, LTD., *et al.*,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF OF WASHINGTON LEGAL FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICUS CURIAE*[1]

The Washington Legal Foundation ("WLF") is a non-profit public interest law and policy center based in Washington, D.C., with supporters in all 50 states. WLF devotes a substantial portion of its resources to defending and promoting free enterprise, individual rights, and a limited and accountable government. To that end, WLF has appeared before this Court and other federal and state courts as *amicus curiae* in numerous cases raising issues relating to the proper scope of the federal securities laws. *See, e.g., Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336 (2005); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S.Ct. 1503 (2006); *In re Stock Exchanges Options Trading Antitrust Litig.*, 317 F.3d 134 (2d Cir. 2003). WLF has no financial interest in the outcome of this case.

The questions presented here – including the proper interpretation of Congress's heightened pleading requirements in the Private Securities Litigation Reform Act of 1995 – involve legal issues of fundamental importance to the financial industry, investors, and the national economy. WLF has a vital interest in ensuring that the uniform standards adopted by Congress to curb abuse of the federal securities laws are not undermined by the adoption of an interpretation that effectively nullifies the heightened standards Congress enacted. WLF is concerned that if the Seventh Circuit's decision below is not reversed, opportunistic plaintiff attorneys will continue to abuse the litigation process, contrary to Congress's express decision to

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[1] Letters from the parties consenting to the filing of this brief have been lodged with the Clerk of the Court. Pursuant to this Court's Rule 37.6, *amicus* states that no counsel for any party authored this brief, in whole or in part, and that no entity or person, aside from *amicus* and its counsel, made any monetary contribution to the preparation or submission of this brief.

raise the pleading requirements for federal securities lawsuits. Such a result would likely interfere with the efficient functioning of the United States economy. As *amicus curiae*, WLF believes that the arguments set forth in this brief will assist the Court in determining and resolving the issues presented in this appeal.

SUMMARY OF ARGUMENT

For important policy reasons, Congress in the Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737, 747 ("PSLRA"), adopted a heightened and strict pleading standard by mandating that federal securities fraud complaints must "state with particularity facts giving rise to a strong inference that the defendant acted with the requisite state of mind." 15 U.S.C. § 78u-4(b)(2). The Seventh Circuit, in reversing the district court's order dismissing the complaint in this action, adopted an incorrect interpretation of the PSLRA's pleading standard that serves to undermine the very purpose of the statutory enactment.

Under this Court's authorities, Congress's "strong inference" pleading standard in the PSLRA should be interpreted in accordance with the plain and ordinary meaning of the words employed. But the Seventh Circuit erroneously interpreted the phrase "strong inference" to mean that a motion to dismiss should be denied if any "reasonable" inference of scienter could be drawn from the complaint's allegations. *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 437 F.3d 588, 601-03 (7th Cir. 2006). The Seventh Circuit adopted this startlingly weak construction in order to evade what it viewed to be a possible constitutional question with respect to the plaintiff's Seventh Amendment right to jury trial. *Id.* at 601-02. This was error and, in fact, the PSLRA's pleading standard raises no genuine constitutional issues under this Court's Seventh Amendment jurisprudence.

Congress plainly has the authority to establish the rules that govern federal statutory causes of action, and to direct the dismissal of complaints by federal courts as legally inadequate where Congress's chosen standards have not been met. Indeed, this Court has recognized Congress's clear authority to set or elevate the governing standards for the very securities fraud claims at issue here. *See Herman & MacLean v. Huddleston*, 459 U.S. 375, 389 (1983); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 748-49 (1975).

The Seventh Amendment has never been interpreted to prevent Congress from establishing legal standards and pleading rules that, if not satisfied by plaintiffs, require dismissal by the court and thereby preclude the plaintiff from getting to a jury. Rather, as the Court has held, the Seventh Amendment preserves "'the basic institution of jury trial in only its most fundamental elements[.]'" *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 336-37 (1979) (quoting *Galloway v. United States*, 319 U.S. 372, 392 (1943)). The Seventh Amendment does not preserve, or otherwise constrain, "'the great mass of procedural forms and details'" by which the courts control litigation and regulate the jury's role on questions of fact, *id.*, including the application of new rules that may lead to the termination of litigation and prevent a party from ever reaching a jury. *See also Fidelity & Deposit Co. of Maryland v. United States*, 187 U.S. 315, 320 (1902); *Ex parte Peterson*, 253 U.S. 300, 309-10 (1920); *Galloway*, 319 U.S. at 389-91.

The PSLRA's heightened pleading requirements and accompanying motion to dismiss, 15 U.S.C. §§ 78u-4(b)(1), 4(b)(2), 4(b)(3)(A), effectively alter and amend Federal Rules of Civil Procedure 8(a), 9(b), and 12(b)(6), as applied to certain federal securities claims. Nothing in the Seventh Amendment ties Congress or the courts either "to the common-law system of pleading," *Galloway*, 319 U.S. at 390, or to any particular pleading rules in the Federal Rules of

Civil Procedure or otherwise, *see also Fidelity & Deposit Co. of Maryland*, 187 U.S. at 319-21. Properly understood, Congress in the PSLRA has merely established the legal rules and standards that private securities fraud plaintiffs must satisfy in their complaints – as a matter of law – before they may seek discovery and, in appropriate cases, present a securities fraud claim to a jury for its "ultimate determination." *Ex parte Peterson*, 253 U.S. at 310. When granting a motion to dismiss for failure to comply with Congress's heightened pleading standards in the PSLRA, courts are making the sort of threshold legal determinations that do not impinge upon any jury-trial rights preserved by the Seventh Amendment.

Once the Seventh Amendment underbrush is cleared, it is apparent that the Seventh Circuit woefully misinterpreted the PSLRA's "strong inference" standard. Consistent with the plain meaning of the words employed by Congress, a "strong inference" of scienter is *not* merely any "reasonable" inference that "could" be drawn. *Makor Issues & Rights, Ltd.*, 437 F.3d at 602. Rather, to survive a motion to dismiss under the PSLRA, the complaint's particularly pled facts must collectively give rise to an inference of scienter that is "both reasonable and 'strong'[.]" *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 196 (1st Cir. 1999).

While reversing the Seventh Circuit here, the Court should adopt an interpretation of the PSLRA's heightened pleading standard that directs courts to assess whether the totality of a securities fraud complaint's well-pleaded particularized facts, when assumed to be true, give rise to a sufficiently strong inference of scienter. *See, e.g., Pirraglia v. Novell, Inc.*, 339 F.3d 1182, 1187 (10th Cir. 2003). In making that determination, courts should be directed to consider all possible inferences that arise from the well-pleaded particularized facts, including both ones favorable and unfavorable to plaintiff's ultimate allegation that the

defendant acted with the requisite scienter. *Id.*; *Gompper v. VISX, Inc.*, 298 F.3d 893, 896-97 (9th Cir. 2002); *accord*, *In re Credit Suisse First Boston Corp.*, 431 F.3d 36, 49 (1st Cir. 2005); *Ottman v. Hanger Orthopedic Group, Inc.*, 353 F.3d 338, 345, 350 (4th Cir. 2003); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001).

Consistent with standards this Court has adopted elsewhere, no sufficiently "strong" inference of scienter should exist as a matter of law if there is merely an attenuated, weak, indirect or speculative connection between the complaint's well-pleaded particularized facts and the defendant's having acted with the requisite scienter,[2] and unless the complaint's particularly pled scienter allegations tend to exclude the defendant's having acted with a non-culpable mental state.[3]

For the reasons set forth further below, the Court should reverse on the ground that the Seventh Circuit applied an incorrect legal standard, and remand for further proceedings consistent with the Court's opinion.

ARGUMENT

I. CONGRESS ENACTED THE PSLRA'S HEIGHTENED PLEADING REQUIREMENTS FOR POLICY REASONS TO PREVENT AND DETER MERITLESS SECURITIES FRAUD LITIGATION

Congress in the PSLRA enacted a series of provisions designed to curb serious "perceived abuses" of the federal securities laws in actions brought pursuant to Section 10(b) of

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[2] *Cf.*, *Associated General Contractors of California Inc. v. California State Council of Carpenters*, 459 U.S. 519, 535-46 (1983).

[3] *Cf.*, *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 588 (1986).

the Securities Exchange Act of 1934 and Rule 10b-5. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 126 S.Ct. 1503, 1510 (2006); *see also* H.R. Rep. No. 104-369, at 31 (1995) (Conf. Rep.) (noting "significant evidence of abuse in private securities lawsuits," including "routine filing of lawsuits ... whenever there is a significant change in an issuer's stock price, without regard to any underlying culpability of [the defendants]," and "abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized [defendants] to settle"), *as reprinted in* 1995 U.S.C.C.A.N. 730, 730.

This Court has long recognized the potential for private litigant abuse of the federal securities laws, *see, e.g.*, *Blue Chip Stamps*, 421 U.S. at 739-41; *Dabit*, 126 S.Ct. at 1510, and Congress in the PSLRA determined that the *actuality* of such abuses warranted remedial legislation.

In an "effort to deter or at least quickly dispose of those suits whose nuisance value outweighs their merits," Congress placed "special burdens" on plaintiffs seeking to bring federal securities fraud actions. *Dabit*, 126 S.Ct. at 1511.

In particular, Congress "impose[d] heightened pleading requirements" on private securities fraud plaintiffs. *Id.* These include not only the requirement that "securities fraud complaints 'specify' each misleading statement" and "set forth the facts 'on which [a] belief' that a statement is misleading was 'formed'," but also the demand that such complaints must "'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" *Dura Pharmaceuticals, Inc. v. Broudo*, 544 U.S. 336, 345 (2005) (quoting 15 U.S.C. §§ 78u-4(b)(1), (2)); *accord*, *Dabit*, 126 S.Ct. at 1511.[4]

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[4] As this Court has held, scienter – the "intent to deceive, manipulate, or defraud" – is an essential element to any private securities fraud damages claim. *Ernst & Ernst v. Hochfelder*, 425

In addition, Congress in the PSLRA explicitly provided for a "motion to dismiss" premised upon any "failure to meet" the "pleading requirements" of 15 U.S.C. §§ 78u-4(b)(1) and (b)(2), and therein directed that the "court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met." 15 U.S.C. § 78u-4(b)(3)(A). Congress further directed that "all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party." 15 U.S.C. § 78u-4(b)(3)(B).

Prior to the PSLRA, federal securities fraud complaints were adjudged under Federal Rule of Civil Procedure 9(b), which states: "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally."

For policy reasons, Congress determined that the general pleading requirements of the Federal Rules of Civil Procedure had proven inadequate to prevent "abuse of the securities laws by private litigants." H.R. Rep. No. 104-369, at 41, *as reprinted in* 1995 U.S.C.C.A.N. at 740; *accord*, *Dabit*, 126 S.Ct. at 1510. Congress altered the operation of those rules only with respect to federal securities fraud claims by enacting 15 U.S.C. § 78u-4(b).

As relevant here, the PSLRA's heightened pleading standard has two core components. First, Congress extended Rule 9(b)'s particularity pleading requirement to the issue of scienter, mandating that "with respect to each act or omission" alleged to violate the federal securities laws, the

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U.S. 185, 193 (1976). Given the securities fraud claims in this case, that is the "required state of mind" referenced in the PSLRA's heightened pleading standard under 15 U.S.C. § 78u-4(b)(2).

complaint must state "facts" concerning the defendant's allegedly culpable mental state "with particularity." 15 U.S.C. § 78u-4(b)(2).

Second, Congress elevated the legal standard governing what circumstantial factual allegations may be considered sufficient to allege the defendant's requisite scienter, by insisting that the complaint's particularly pled facts must "giv[e] rise to a *strong inference* that the defendant acted with the required state of mind." *Id.* (emphasis added). As several courts have noted, the PSLRA alters that aspect of the ordinary practice on motions to dismiss under Rule 12(b)(6) which previously may have given plaintiffs the benefit of any "reasonable" inference that might be drawn from the complaint's well-pleaded factual allegations. *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 195-96 (1st Cir. 1999); *see also In re Digital Island Sec. Litig.*, 357 F.3d 322, 328 (3d Cir. 2004); *Gompper v. VISX, Inc.*, 298 F.3d 893, 896-97 (9th Cir. 2002); *Florida State Bd. of Admin. v. Green Tree Financial*, 270 F.3d 645, 660 (8th Cir. 2001); *Helwig v. Vencor, Inc.*, 251 F.3d 540, 553 (6th Cir. 2001). Congress altered this practice with respect to inferences at the pleading stage, as applied to motions to dismiss under the PSLRA including the "motion to dismiss" explicitly recognized under 15 U.S.C. § 78u-4(b)(3)(A).

There can be no doubt that, as a general proposition, Congress has the authority to enact legislation that heightens pleading standards beyond those otherwise applicable under the Federal Rules of Civil Procedure.[5] Although federal courts may "not by judicial interpretation" heighten pleading standards for particular claims, this Court has acknowledged

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[5] Indeed, Congress indisputably has the general power and constitutional authority to establish and amend the "rules governing the practice and pleading in th[e federal] courts." *Hanna v. Plumer*, 380 U.S. 460, 472 (1965).

the authority of *Congress* to do so. *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 515 (2002) ("requirement of greater specificity for particular claims is a result that 'must be obtained by the process of amending the Federal Rules'") (quoting *Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168 (1993)).

It is equally clear that Congress has the authority to amend and strengthen the legal standards and pleading rules by which private federal securities fraud complaints are measured and adjudged – just as Congress has the authority to alter and heighten the "standard of proof" applicable to such claims. *Huddleston*, 459 U.S. at 389 (judicially prescribing standard of proof for private Section 10(b) securities fraud claims where "Congress has not prescribed the appropriate standard"); *see also Blue Chip Stamps*, 421 U.S. at 748-49 ("if Congress had legislated" particular requirements to govern the private implied right of action judicially found to exist under section 10(b) and Rule 10b-5, "the duty of the Judicial Branch would be to administer the law which Congress enacted").

This is precisely what Congress has done in the PSLRA. It has amended the law to establish heightened pleading standards applicable to certain private actions under the federal securities laws, and explicitly directed courts to dismiss complaints at the pleading stage when those standards have not been met. Consequently, it is the duty of the Judicial Branch to administer the law which Congress has enacted.

II. THE PSLRA'S PLEADING STANDARD SHOULD BE INTERPRETED IN ACCORDANCE WITH THE PLAIN AND ORDINARY MEANING OF THE WORDS EMPLOYED BY CONGRESS

At the core of this Court's resolution of the split among the Circuits with respect to the PSLRA lies the proper

interpretation of the "strong inference" standard under 15 U.S.C. § 78u-4(b)(2).

The Court should construe the operative phrase "strong inference" in accordance with the plain and ordinary meaning of the words employed, just as it would the language used in any other statute. *See, e.g., BP Am. Prod. Co. v. Burton*, 127 S.Ct. 638, 643 (2006) ("Unless otherwise defined, statutory terms are generally interpreted in accordance with their ordinary meaning."); *S. D. Warren Co. v. Me. Bd. of Envtl. Prot.*, 126 S.Ct. 1843, 1846 (2006) (because statutory term "discharge" in Section 401 of the Clean Water Act is "neither defined in the statute nor a term of art," it must be construed "in accordance with its ordinary or natural meaning"); *Aaron v. S.E.C.*, 446 U.S. 680, 700 (1980) ("In the absence of a conflict between reasonably plain meaning and legislative history, the words of the statute must prevail.").

Indeed, the Court should interpret the PSLRA's pleading requirements in accordance with the plain meaning of the statutory terms employed just as the Court has repeatedly interpreted the language employed in the Federal Rules of Civil Procedure in accordance with their "plain meaning." *Business Guides, Inc. v. Chromatic Communications Enters., Inc.*, 498 U.S. 533, 540 (1991); *Pavelic & LeFlore v. Marvel Entertainment Group*, 493 U.S. 120, 123 (1989).

The plain and ordinary meaning of "inference" is not disputed. Leading dictionaries define the word to mean "the act of passing from one or more propositions . . . considered as true to another the truth of which is believed to follow from that of the former," WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY 1158 (2002); and the "act or process of deriving logical conclusions from premises known or assumed to be true." AMERICAN HERITAGE COLLEGE DICTIONARY 710 (4th ed. 2004); *accord*, BLACK'S LAW DICTIONARY 778 (6th ed. 1990) ("inference" defined as meaning the "process of reasoning by which a fact or proposition sought to be

established is deduced as a logical consequence from other facts, or a state of facts, already proved or admitted").

Further, the plain and ordinary meaning of the word "strong" includes "powerful," "forceful and pointed," "persuasive, effective, and cogent," "intense in degree or quality," and "readily detected or received." AMERICAN HERITAGE COLLEGE DICTIONARY, at 1369; WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY, at 2265 (further defining "strong" as including "striking or superior of its kind," "having a particular quality in great degree," "well established," "firmly fixed," and "not easily altered or eradicated"); *see also* BLACK'S LAW DICTIONARY, at 1423 (defining "strong" as "cogent, powerful, forcible, forceful").[6]

Interpreting the PSLRA's "strong inference" standard in accordance with the plain and ordinary meaning of the words employed is consistent with the purpose of this statutory amendment. Both the Senate Report and House Conference Report indicate that Congress chose the PSLRA's scienter pleading standard, derived in part from the Second Circuit's standard, because it was regarded as "the most stringent pleading standard." S. Rep. No. 104-98, at 15 (1995), *as reprinted in* 1995 U.S.C.C.A.N. 679, 694; H.R. Rep. No. 104-369, at 41, *as reprinted in* 1995 U.S.C.C.A.N. at 740; *see also Florida State Bd. of Admin.*, 270 F.3d at 656-57. Yet Congress elected to adopt only the language of the standard (*i.e.*, "strong inference"), and did "not intend to codify the

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[6] The ordinary and plain meaning of the word "weak" inversely corresponds to the definition of "strong." *See, e.g.*, AMERICAN HERITAGE COLLEGE DICTIONARY 1552 (4th ed. 2004) (defining "weak" as "[l]acking physical strength, energy, or vigor; feeble"; "Likely to fail under pressure, stress, or strain"; "Lacking firmness of character or strength of will"; "Lacking the proper strength or amount of ingredients"; "Lacking persuasiveness; unconvincing"; and "Lacking potency or intensity").

Second Circuit's caselaw interpreting this pleading standard, although courts may find this body of law instructive." S. Rep. No. 104-98, at 15, *as reprinted in* 1995 U.S.C.C.A.N. at 694.[7] Hence, Congress left it to the courts, and ultimately this Court, to interpret the content of the PSLRA's "strong inference" standard as a matter of statutory construction.

When Congress's "strong inference" standard is assessed in accordance with the plain and ordinary meaning of the words employed, there can be no question that the Seventh Circuit's construction does violence to the statutory text. Indeed, the Seventh Circuit interpreted the PSLRA's "strong inference" standard in a manner that read the critical word "strong" out of the statute, and effectively replaced it with the word "reasonable." *See Makor Issues & Rights, Ltd.*, 437 F.3d at 601-03. According to the Seventh Circuit, the proper interpretation of the PSLRA's "strong inference" standard is one that "will allow the complaint to survive if it alleges facts from which, if true, a *reasonable person could infer* that the defendant acted with the required intent." *Id.* at 602 (emphasis added). It is only when *no* reasonable person possibly could draw *any inference* that the defendant acted with scienter that – under the Seventh Circuit's erroneous interpretation – a motion to dismiss may be granted under the PSLRA on the ground that the complaint fails as a matter of law to meet the requirements of 15 U.S.C. § 78u-4(b)(2). *Id.*

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[7] Those circuit courts that have canvassed the PSLRA's legislative history in an effort to divine the proper interpretation of the strong inference standard have concluded that it is ultimately "ambiguous and even contradictory" on that question, *Nathenson v. Zonagen Inc.*, 267 F.3d 400, 411 (5th Cir. 2001); *In re Advanta Corp. Sec. Litig.*, 180 F.3d 525, 531 (3d Cir. 1999), and does not provide any clear indication of congressional intent, *Florida State Bd. of Admin.*, 270 F.3d at 656-58.

The Seventh Circuit's holding in this respect is wrong as a matter of statutory construction. A "strong inference" of scienter, 15 U.S.C. § 78u-4(b)(2), is not merely any *reasonable* inference that could be drawn, and nothing in the statutory text or legislative history remotely supports the Seventh Circuit's construction to that effect. Under the PSLRA, "inferences of scienter survive a motion to dismiss only if they are both reasonable and 'strong' inferences." *Greebel*, 194 F.3d at 195-96; *accord*, *Florida State Bd. of Admin.*, 270 F.3d at 660. The construction adopted by the Seventh Circuit reduces the standard back down to the ordinary pleading interpretive rules that Congress explicitly heightened by adopting the PSLRA's "strong inference" standard, which defeats the very purpose of the statutory amendment.

In determining whether an inference of scienter is sufficiently "strong," courts must engage in deductive reasoning to assess the *relationship* between a complaint's particularly pled facts and the ultimate allegation that defendant acted with the requisite scienter, which is an essential element to the claim. *See Ernst & Ernst*, 425 U.S. at 193. The relationship must be sufficiently close and proximate, and sufficiently forceful and striking, to constitute the sort of "strong inference" of scienter that Congress has required to survive a motion to dismiss. *Cf.*, *In re Burlington Coat Factory Sec. Litig.*, 114 F.3d 1410, 1422-24 (3d Cir. 1997) (Alito, J.). If, in the totality of the complaint's particularly pled factual allegations, this process of deductive reasoning reveals only a weak and attenuated connection, then a motion to dismiss should be granted as a matter of law. Consistent with the plain meaning of the textual phrase "strong inference" in 15 U.S.C. § 78u-4(b)(2), the complaint's particularized allegations with respect to the defendant's mental state – when taken together and assumed to be true – must rationally provide a powerful, cogent, and forceful basis

upon which to conclude that the defendant acted with the requisite intent to deceive or scienter. *See supra* pp. 10-11.

The stated reason why the Seventh Circuit adopted its strikingly relaxed construction of the PSLRA's "strong inference" standard was to avoid any possible Seventh Amendment issue from arising. *See* 437 F.3d at 601-03. But this analysis cannot withstand scrutiny. Specifically, the Seventh Circuit identified the possibility that some interpretations of the "strong inference" requirement "could potentially infringe upon plaintiffs' Seventh Amendment rights." *Id.* at 602 (citing *Fidel v. Farley*, 392 F.3d 220, 227 (6th Cir. 2004)). But after identifying the issue, the Court of Appeals "express[ed] no view" on whether any interpretation "is in fact unconstitutional" and, indeed, engaged in no constitutional analysis at all. *Id.* Instead, the panel of the Seventh Circuit elected to adopt a construction of the PSLRA's strong inference standard "that cannot be misunderstood as a usurpation of the jury's role." *Id.* In effect, the Seventh Circuit adopted its strained interpretation of the words employed by Congress to *save* the statute from a theoretical and hypothesized constitutional infirmity that was not argued by plaintiffs to exist, and not even determined by the Seventh Circuit to exist. However, as detailed further below, Congress's heightened pleading standard in the PSLRA does not implicate any genuine constitutional issues under this Court's Seventh Amendment jurisprudence.

III. THE PSLRA'S PLEADING STANDARD DOES NOT IMPINGE UPON THE SEVENTH AMENDMENT RIGHT TO JURY TRIAL

The Seventh Amendment to the United States Constitution provides:

> In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no

> fact tried by a jury shall be otherwise re-examined in any Court of the United States, than according to the rule of the common law.

U.S. CONST., amend. VII.[8]

Consistent with its "historical objective," the Seventh Amendment operates to preserve "'the substance of the common-law right of trial by jury" as it existed in 1791 when the amendment was adopted. *Colgrove v. Battin*, 413 U.S. 149, 156 (1973) (quoting *Baltimore & Carolina Line, Inc. v. Redman*, 295 U.S. 654, 657 (1935)); *Parklane Hosiery Co., Inc. v. Shore*, 439 U.S. 322, 333 (1979) (The "'thrust of the Seventh Amendment was to preserve the right to jury trial as it existed in 1791.'") (citation and brackets omitted). To this end, the "ultimate determination of issues of fact" is a "jury" function preserved by the Seventh Amendment. *Ex parte Peterson*, 253 U.S. 300, 310 (1920). "The controlling distinction between the power of the court and that of the jury is that the former is the power to determine the law and the latter to determine the facts." *Dimick v. Schiedt*, 293 U.S. 474, 486 (1935).

But, importantly, the Seventh Amendment "was designed to preserve the basic institution of jury trial in only its most fundamental elements, not the great mass of procedural forms and details, varying even then so widely among common-law jurisdictions" in 1791. *Parklane Hosiery Co.*, 439 U.S. at 337 (internal quotations and citation omitted). The Seventh Amendment "'did not bind the federal courts to the exact procedural incidents or details of jury trial according to the

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[8] Only the first clause of the Seventh Amendment is conceivably implicated at all here (*i.e.*, "In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved"), and not the second clause, given that the PSLRA's pleading standard involves no judicial re-evaluation of any "fact tried to a jury."

common law in 1791, any more than it tied them to the common-law system of pleading or the specific rules of evidence then prevailing.'" *Id.* at 336-37 (citation omitted); *accord*, *Ex parte Peterson*, 253 U.S. at 309; *Fidelity & Deposit Co. of Maryland v. United States*, 187 U.S. 315, 319-21 (1902); *see also Walker v. New Mexico & So. Pac. R. Co.*, 165 U.S. 593, 596 (1897) (Seventh Amendment "does not attempt to regulate matters of pleading"). "Nor were 'the rules of the common law' then prevalent, including those relating to the procedure by which the judge regulated the jury's role on questions of fact, crystallized in a fixed and immutable system." *Galloway v. United States*, 319 U.S. 372, 390-91 (1943).

This Court's Seventh Amendment jurisprudence has never questioned the role of courts as gate-keepers who may dispose of cases *on legal grounds* – including grounds related to the legal insufficiency of plaintiffs' pleaded allegations or evidentiary proof – even though that necessarily prevented parties from ever getting to a jury. "No one is entitled in a civil case to trial by jury unless and except so far as there are issues of fact to be determined." *Ex parte Peterson*, 253 U.S. at 310. To be sure, the "ultimate determination of issues of fact" is a constitutionally preserved function of the "jury." *Id.* But nothing in the Seventh Amendment prevents Congress from establishing or modifying, and the courts from then applying, the rules and standards whose operation at the pleading stage (or otherwise) may lead to dismissal of claims on legal grounds that parties might otherwise wish to be tried to a jury.

Indeed, this Court's decisions have long recognized that, before any party can reach a jury, "there is a preliminary question for the judge" whether the alleged facts or evidence are legally sufficient to enable a jury to "properly proceed to find a verdict" in favor of the party "upon whom the onus of proof is imposed." *Improvement Co. v. Munson*, 81 U.S. 442,

448 (1871); *see also Pennsylvania Railroad Co. v. Chamberlain*, 288 U.S. 333, 343 (1933); *Gunning v. Coolley*, 281 U.S. 90, 94 (1930); *Fidelity & Deposit Co. of Maryland v. United States*, 187 U.S. at 319-21. In making such legal determinations, it is well settled that courts must take into account the legal rules and standards of proof governing the claims at issue, including any elevated standards imposed upon the party bearing the ultimate burden of proof at trial. *See, e.g., Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252, 254-56 (1986).

Consistent with the Seventh Amendment, this Court has approved an array of legal and procedural mechanisms employed by courts to dismiss or otherwise dispose of claims in accordance with the governing legal standards – including motions for "summary judgment," *Parklane Hosiery*, 439 U.S. at 336 (citing *Fidelity & Deposit Co. of Maryland*, 187 U.S. at 319-21); motions for a directed verdict, *see, e.g., Galloway*, 319 U.S. at 388-93; and motions for judgment notwithstanding the verdict granted by trial or appellate courts, *see Weisgram v. Marley Co.*, 528 U.S. 440, 449-50 (2000); *Neely v. Martin K. Eby Construction Co.*, 386 U.S. 317, 321-22 (1967); *Baltimore & Carolina Line, Inc.*, 295 U.S. at 660-61. A motion to dismiss under modern-day practice – which is a "lineal descendant" of the "general demurrer" that existed under common-law pleading rules, 5B Charles Alan Wright & Arthur R. Miller, FEDERAL PRACTICE & PROCEDURE: CIVIL 3D § 1355, at 351-53 (2004); *see also Greene v. Louisville & I.R. Co.*, 244 U.S. 499, 502-03 (1917) ("motion to dismiss" is "equivalent to a general demurrer") – fits squarely within this category of legal and procedural mechanisms "developed since 1791 that have diminished the civil jury's historic domain [but] have been found not to be inconsistent with the Seventh Amendment." *Parklane Hosiery Co.*, 439 U.S. at 336.

Fidelity & Deposit Co. of Maryland is instructive. There, the Court held that Rule 73 of the Supreme Court of the District of Columbia did not violate the Seventh Amendment's right to jury trial, but rather merely "prescribe[d] the means of making an issue" prior to the accrual of any jury trial right. *See* 187 U.S. at 319-22. Rule 73 required parties in certain actions *ex contractu* to file sworn particularized affidavits, along with their pleas, which set forth distinctly the bases for their claims and defenses. When defendant's affidavit did not satisfy Rule 73's requirements (and instead generally purported to exercise the party's Seventh Amendment right to trial by jury), judgment was entered for plaintiff. On appeal, defendant argued that Rule 73, as applied, violated the Seventh Amendment. The Court held, however, that the rule prescribed the "means" by which parties are required to make "an issue" sufficiently to entitle them to proceed further and get to any jury. *Id.* at 319-20. The "right of trial by jury accrues," the Court explained, only once the "issue" has properly been "made as prescribed" by the governing rules. *Id.* at 320. Hence, the Court rejected the contention that the Seventh Amendment creates any "constitutional right to old forms of procedure," and confirmed that "Congress has [the] power to change" the rules at issue, including the means by which parties are required to "make an issue" sufficient to proceed further with their claims or defenses. *Id.* at 320-21.

Here, Congress in the PSLRA has amended the rules establishing what private securities fraud litigants must plead in order to "make an issue" sufficiently in their pleadings to get past a motion to dismiss. *Id.* A plaintiff's failure to plead with particularity facts sufficient to give rise to the Congressionally required "strong inference" of scienter operates to preclude the plaintiff from proceeding further with any securities fraud claim. *See* 15 U.S.C. § 78u-4(b). Indeed, Congress authorized a particular "motion to dismiss" in the PSLRA, and directed that federal courts "shall . . . dismiss"

complaints that, in the courts' assessments, do not satisfy the PSLRA's heightened pleading requirements. 15 U.S.C. § 78u-4(b)(3)(A). As a result, there simply are no issues of fact to be tried, because the plaintiff's complaint has been held *legally insufficient* under the governing standard established by Congress and applied by the courts. *See also Swierkiewicz*, 534 U.S. at 511 (On motions to dismiss under Rule 12(b)(6), "'[t]he issue is not whether a plaintiff will ultimately prevail but whether the claimant is entitled to offer evidence to support the claims.'") (quoting *Scheuer v. Rhodes*, 416 U.S. 232, 236 (1974)).

In this sense, the Court is presented here with one of the many forms and details of pleading, and related legal standards, that do not genuinely implicate any jury trial right under the Seventh Amendment. Congress has elevated the pleading burden applicable to securities fraud plaintiffs based on a policy judgment that it has made, given its determination that the formerly more lax pleading rules and legal standards that previously applied to the federal statutory cause of action at issue had permitted abusive and vexatious litigation that was not in the Nation's best interests. *See* S. Rep. No. 104-98, at 8-10, *as reprinted in* 1995 U.S.C.A.N.N. at 687-89; H.R. Rep. No. 104-369, at 31-32, *as reprinted in* 1995 U.S.C.A.N.N. at 730-31; *Dabit*, 126 S.Ct. at 1510-11. This decision was entirely within the permissible province of Congress and does not run afoul of any rights protected by the Seventh Amendment. This is particularly so where, as here, Congress has legislated a heightened pleading standard with respect to a judicially implied cause of action that is solely a creature of federal statute, did not exist at common law, and could entirely be abolished by Congress without raising any Seventh Amendment issues at all.

In granting a motion to dismiss based on a plaintiff's failure to plead particularized facts sufficient to satisfy the PSLRA's "strong inference" standard, a court is not invading

any sole province of the jury as to determinations relegated exclusively to the trier of fact by the Seventh Amendment. The court is not making ultimate factual determinations. It is not making credibility assessments. Nor is it determining as a factual matter whether the defendant did, or did not, act with the requisite level of scienter. Hence, there is no "usurpation of the jury's role," *Makor Issues & Rights, Ltd.*, 437 F.3d at 602, when courts engage in the analysis required by Congress at the pleading stage under the PSLRA.

Rather, the court is assessing and determining – as a matter of law – whether the *quantum* of particularly pled facts alleged in the complaint (when taken together and assumed to be true) is sufficient to rise to the requisite *legal standard* established by Congress as the baseline that must be passed as a pleading matter to survive a motion to dismiss under the PSLRA. In determining that a given complaint fails to plead particularized facts sufficient to give rise to a "strong inference" that the defendant acted with the requisite scienter, and therefore must be dismissed, the court is performing a classic judicial gate-keeping function. It is testing the legal sufficiency of the complaint's allegations against the standard established by Congress. It is determining that the complaint fails to plead facts sufficient to allege the essential element of scienter in the manner dictated by Congress.[9]

The Seventh Circuit was apparently unwilling to accept and apply the PSLRA's "strong inference" standard out of allegiance to the usual Rule 12(b)(6) standard generally

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[9] In this sense, the court is merely applying the governing legal standard "bear[ing] in mind the actual quantum and quality of proof" required by Congress, while interpreting and applying the legal "benchmark" established in the PSLRA. *Anderson v. Liberty Lobby.*, 477 U.S. at 254-55 (emphasizing that the judicial gate-keeping function performed on summary judgment or directed verdict motions "does not denigrate the role of the jury").

applied by the courts, in which they give plaintiffs the benefit of all "reasonable" inferences from the complaint's well-pleaded factual allegations. *Makor Issues & Rights, Ltd.*, 437 F.3d at 602. But it is clearly a mistake to confuse traditional practice with constitutional mandate. Congress in the PSLRA explicitly raised the pleading hurdles for plaintiffs in securities fraud cases. It changed the typical rules that the courts are accustomed to apply. The Seventh Circuit committed clear error by interpreting the PSLRA's "strong inference" standard as no different than the former pleading interpretation rules that Congress altered by enacting 15 U.S.C. 78u-4(b). Certainly nothing in the Seventh Amendment commands courts to disregard the actual and heightened pleading rules imposed by Congress under the PSLRA, and to adopt a watered down construction that effectively nullifies the heightened standard and returns it to the former standard Congress plainly intended to replace.

When undertaking the analysis required under the PSLRA, courts are not engaging in any impermissible weighing of the evidence to determine matters of fact; they are engaging in legal reasoning to assess and evaluate whether the particularly pled facts alleged in the complaint are *sufficient as a matter of law* to surpass the governing standard established by Congress. *See, e.g., Pirraglia*, 339 F.3d at 1187. To the extent that making this legal determination involves any "weighing" of the complaint's particularly pled factual allegations to determine if they surpass the legal standard established by Congress in the PSLRA, the Seventh Amendment does not prohibit it. *See, e.g., Galloway*, 319 U.S. at 390 (emphasizing that, even "in 1791," the "jury was not absolute master of fact": "courts . . . weighed the evidence, not only piecemeal but *in toto* for submission to the jury," pursuant to various gate-keeping legal and procedural mechanisms).

Moreover, it proves too much to posit that the Seventh Amendment mandates that Congress may *never* adopt any legal standard – at the pleading stage or otherwise – that is higher than a mere "reasonable" inference standard. What the Seventh Amendment preserves is the basic institution of jury trial only in its most fundamental elements, *Parklane Hosiery Co.*, 439 U.S. at 337, which ensures that the "ultimate determination of issues of fact" shall be made "by the jury." *Ex parte Peterson*, 253 U.S. at 310. The Seventh Amendment does not establish any "reasonable" inference standard as an irreducible constitutional floor and ceiling, just as it does not mandate any particular pleading rules, evidentiary standards, procedural requirements, or standards of proof. *See, e.g., id.* at 309-10; *Galloway*, 319 U.S. at 390-91; *Fidelity & Deposit Co. of Maryland*, 187 U.S. at 319-21.[10]

In short, a court's determination of the legal question of what quantum of particularly pled facts gives rise to a sufficiently "strong" inference of scienter, 15 U.S.C. § 78u-4(b)(2), does not invade the jury's fact finding function preserved by the Seventh Amendment. It is a threshold legal determination for the courts, akin to the sort of legal determinations this Court has long approved without running afoul of the Seventh Amendment.

A defendant who acted innocently, or even just negligently, has not violated the federal securities laws. *See Ernst & Ernst*, 425 U.S. at 193; *Huddleston*, 459 U.S. at 382-83. Under the PSLRA, if the adverse inferences drawn from the particularly pled facts in the complaint do not *tend to*

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[10] These are policy matters for Congress to determine, especially with respect to particular federal causes of action. *See, e.g., Galloway*, 319 U.S. at 395 (emphasizing that the "standards" governing what quantum of proof is legally sufficient involve questions "to be worked out in particular situations and for particular types of cases").

exclude the defendant's having acted with a non-culpable mental state, then Congress's "strong inference" standard in the PSLRA should not be met as a matter of law. In that circumstance, the complaint's particularly pled facts – even when assumed to be true on a motion to dismiss – would simply be too weak, tenuous, and speculative to establish a sufficiently "strong inference" of scienter and, therefore, would be legally insufficient to survive a motion to dismiss. Such a construction of the PSLRA's heightened pleading standard is consistent with other decisions of this Court on motions to dismiss or for summary judgment and, thus, would plainly comport with the Seventh Amendment. *See, e.g.*, *Matsushita Elec. Indus. Co.*, 475 U.S. at 587-88 (summary judgment properly granted defendant where plaintiff's evidence did not "tend to exclude" possibility that defendants acted independently, and thus lawfully, rather than collusively, and thus illegally under antitrust laws; "antitrust law limits the range of permissible inferences" that may be drawn "from ambiguous evidence"); *Associated General Contractors*, 459 U.S. at 535-43, 545-46 (Rule 12(b)(6) motion to dismiss properly granted and complaint's allegations held "insufficient as a matter of law" where connection between alleged antitrust violation and plaintiff's alleged injury was too "indirect," "remote," "tenuous and speculative").

CONCLUSION

For the foregoing reasons, this Court should reverse the judgment of the Seventh Circuit, and remand for further proceedings consistent with the Court's opinion.

Respectfully submitted,

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